IN THE COURT OF APPEALS OF TENNESSEE
AT NASHVILLE
September 4, 2002 Session

SPRING HILL, L.P., et al. v. TENNESSEE STATE BOARD OF EQUALIZATION, et al.

Appeal from the Chancery Court for Davidson County
No. 00-152-II Carol McCoy, Chancellor

No. M2001-02683-COA-R3-CV - Filed December 31, 2003

Taxpayers appeal their property tax assessments for the1998 tax year. All of the properties in dispute receive federal income tax credits authorized by § 42 of the Internal Revenue Code of 1986, under the Federal Low Income Housing Tax Credit Program. Taxpayers complain that the county assessors improperly included the present value of the federal tax credits in the valuations of their low-income housing properties, thereby making the assessments too high. The trial court affirmed the decisions of the State Board of Equalization, finding that the tax credits were properly included in the valuations. In addition, Taxpayer Acorn challenges its reclassification from residential to commercial for property tax purposes. The trial court affirmed Acorn's reclassification. We affirm the judgment of the trial court.

Tenn. R. App. P. 3 Appeal as of Right; Judgment of the Chancery Court Affirmed and Remanded

PATRICIA J. COTTRELL, J., delivered the opinion of the court, in which BEN H. CANTRELL, P.J., M.S., and ALLEN W. WALLACE, SP. J., joined.

Grant C. Glassford, Bryan E. Pieper, Paul D. Krivacka, Nashville, Tennessee, for the appellants, Spring Hill, L.P., Greentree Pointe, L.P., and Acorn Hills, L.P.

Paul G. Summers, Attorney General and Reporter; Michael E. Moore, Solicitor General; Margaret M. Huff, Assistant Attorney General, for the appellees, Tennessee State Board of Equalization.

Robert O. Binkley, Lewisburg, Tennessee for the appellees Linda Haislip, Marshall County Property Assessor, and Margaret Tyree, Marshall County Trustee.

Michael R. Jennings, Lebanon, Tennessee for the appellees Jennifer Bell, Wilson County Property Assessor, and Ernest Lasater, Wilson County Trustee.

Stephen H. Price, Dwayne W. Barrett, Michael D. Orr, Nashville, Tennessee, for the Amici Curiae,

Greater Nashville Apartment Association, Tennessee Network for Community Economic Development, and Tennessee Apartment Association.

OPINION

In this consolidated appeal, Taxpayers are three limited partnerships, Spring Hill, L.P., Greentree Pointe, L.P., and Acorn Hills, L.P., that seek judicial review of two Wilson County assessments of their properties, Spring Hill[1] and Greentree Pointe,[2] and one Marshall County assessment regarding Acorn Hills.[3] All of the properties at issue have qualified for, and use, certain federal income tax credits ("Tax Credits" or "LIHTC") authorized by § 42 of the Internal Revenue Code of 1986 under the Federal Low Income Housing Tax Credit Program. Taxpayers complain that the appraisals improperly considered the present value of the Tax Credits in the valuations of their low-income housing properties, thereby making the valuations and resulting assessments too high.[4] In addition, Taxpayer Acorn challenges its reclassification from residential to commercial for property tax purposes

I. BACKGROUND

A. THE LIHTC PROGRAM

The LIHTC program was created as part of the Tax Reform Act of 1986, and utilizes the Internal Revenue Code to provide an incentive for the construction and rehabilitation of low-income rental housing.[5] Specifically, the LIHTC program provides the owners of qualified low-income rental housing an annual credit against federal income tax liability for a ten-year period. The amount of the Tax Credits is based on the costs of the project development and the number of qualified low-

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[1]Spring Hill consists of 10 two-story buildings containing 88 two and three-bedroom units and a clubhouse/office on 12.57 acres in Lebanon, Tennessee.

[2]Greentree Pointe consists of 18 one and two-story buildings containing one, two, and three-bedroom units and a clubhouse/office on 12.27 acres in Lebanon, Tennessee.

[3]Acorn Hills consists of 44 detached single-family rental homes, including 22 two-story units and 22 one-story units in Lewisburg, Tennessee.

[4]This court granted the Greater Nashville Apartment Association, Tennessee Network for Community Economic Development, and Tennessee Apartment Association leave to file an *amici curiae* brief. The *Amici* argue that the trial court misinterpreted the nature of the LIHTC program and that if its ruling stands, the economic incentives for developers to build much needed low-income housing developments within the state will be significantly reduced.

[5]"The LIHTC represents another step in Congress' increasing reliance on the private sector to supply low-income housing. . . . With the continual decline in direct federal funding for low-income housing, the LIHTC has become a substantial housing program. . . . The Congressional Budget Office estimates that the low-income housing tax credit has the potential to become an even larger program, costing as much as $3 billion per year." David Philip Cohen, *Improving the Supply of Affordable Housing: The Role of the Low-Income Housing Tax Credit*, 6 J.L. & POL'Y 537, 538 (1998).

income housing units included in the project. In exchange for the Tax Credits, the developers/owners enter into a binding contractual agreement to restrict the use of the property for the benefit of low-income households.[6] The agreements are binding for a minimum of fifteen years, run with the land, and extend to the owners' successors and assigns. I.R.C. § 42(f),(g). Here, Taxpayers agreed to restricted covenants for a period of thirty years in order to enhance the probability that their applications for the Tax Credits would be accepted. The restrictive covenants are publicly recorded as part of the deed to the property.

The subsidy provided by the Tax Credits is designed to bridge the gap between the value of the property in a restricted use and the cost of development of the project. The market value of the property in a restricted use, as defined by the present value of rental income, will typically represent 30% of the total development cost of the project. Little or no cash will typically be invested as equity in these properties. Instead, the developer will obtain conventional mortgage financing for the 30% portion of the total funds required to develop the project. Tax Credits will then be awarded to provide the remaining 70% portion of the total funds required to develop the project. Once Tax Credits are allocated to a property, the owner can assign the Tax Credits in order to finance the costs of development or rehabilitation of the qualified properties.

This assigning of the Tax Credits is usually accomplished by creating limited partnerships in the development. In exchange for investing in the project, the limited partners are allocated the Tax Credits on an yearly basis and can apply those credits to their tax liability unrelated to the projects for which the credits are awarded. Large companies comprise the majority of the investors in LIHTC projects and use the credits to offset federal income tax liability.[7] In addition to internal

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[6]Typically, forty percent of the units are rented to households whose income does not exceed fifty percent of the area median income, and the remaining sixty percent of the units are rented to households whose income does not exceed sixty percent of the area median income.

[7] Little is known about the LIHTC program outside of the circle of affordable housing developers, syndicators, and some investors who have waded through its sometimes oblique rules to take advantage of this rather unique incentive for the creation of affordable rental housing for lower income people. Neither non profits (because they have no tax liability to offset with the tax credit) nor often developers (because of limitations on the amount of credit that an individual can claim) can use the credit for their own accounts. For this reason, they generally use the vehicle of limited partnership whereby limited partner investors (many individuals or a single or several corporations) buy up to 99% of limited partner interests in the ownership of the development in return for an allocation of up to 90% of the tax credit benefits expected to be realized in the 10-year period . . . .Once a developer has a tax credit reservation, he or she usually will begin serious negotiations for syndicating the development with limited partners and therein receiving equity to be applied to project costs, as well as the developer's own profit. Generally, investors are most interested in the internal rate of return that will be generated from the development, arrived at primarily from an analysis of the tax credit benefits and allowable depreciation.

Jeanne L. Peterson, *The Low-Income Housing Tax Credit*, 73 MICH.B.J. 1154, 1157-8 (1994).

allocations of the Tax Credits through a limited partnership arrangement, the Tax Credits may be sold together with the property to a purchaser who is willing to honor the restrictions on use.[8]

In Tennessee, the Tennessee Housing Development Authority ("THDA") administers the program and monitors compliance with the restrictive covenants agreed to by the participating developers/owners.[9] In the event the owner fails to honor the restricted rent rates, THDA issues notices of non-compliance to the IRS that can result in the disallowance of the Tax Credits to defaulting owners. The application process for the right to participate in the LIHTC Program is governed by policies and procedures established by THDA. The application process is very competitive. Each calendar year, only approximately 33% - 40% of the total applications are approved by THDA and awarded Tax Credits. THDA allocated $6.8 million in Tax Credits during 1999.

The Taxpayers herein are the limited partnerships that own the properties. The LIHTCs awarded to each project were allocated by Taxpayers to various limited partner investors for $.60 on the dollar, and Taxpayers used 100% of the money obtained to finance the construction of the properties. Greentree assigned the right to receive ten annual tax credits of $666,331 for a lump sum of $4,033,439. Spring Hill assigned the right to receive ten annual tax credits of $702,869 for a total of $4,202,317. Acorn assigned the right to receive ten annual tax credits of $393,689 for a lump sum of $2,362,134.

B. THE ASSESSMENTS

The Wilson County and Marshall County assessors included the present value of the Tax Credits in their appraisals of Spring Hill, Greentree, and Acorn. It was the appraisers' opinions that the LIHTCs awarded to the three low-income housing developments have a value enhancing effect. In addition to including the positive effect of the LIHTCs, the appraisers also factored in the value-reducing effect of the restricted rents received by Taxpayers.

The first table below sets forth the impact of the Tax Credits on total value assessed for each of the disputed properties:

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[8]The buyer of the property "steps into the shoes" of the original owner. Assuming the taxpayer who originally qualified for the Tax Credits sells the property and the purchaser continues the low income use, the purchaser is entitled to assume the favorable tax position of the seller under I.R.C. § 42 (d)(7)(A).

[9]State housing agencies play an essential role in the LIHTC program. Cohen, *supra* note 5 at 537. A state's annual credit ceiling is determined by multiplying $1.25 by the state population. I.R.C. § 42(h)(3)(C)(I).

PROPERTY	TOTAL VALUE WITHOUT TAX CREDITS CONSIDERED	TOTAL VALUE WITH TAX CREDITS CONSIDERED	ASSESSMENT IN DISPUTE
Spring Hill	$2,551,987	$4,440,300	$1,775,120
Greentree	$3,512,078	$7,242,400	$2,896,960
Acorn	$1,407,244	$3,821,000	$1,528,450

The second table below sets forth the impact of the Tax Credits on the real property tax due and payable for the 1998 tax year for each of the disputed properties:

PROPERTY	PROPERTY TAX DUE WITH TAX CREDITS	PROPERTY TAX DUE WITHOUT TAX CREDITS	DIFFERENCE[10]
Spring Hill	$ 79,156.88	$52,040.32	$22,131.03
Greentree	$104,134.80	$48,466.68	$51,478.44
Acorn	$ 23,697.99	$64,345.64	$40,647.65

Taxpayers first appealed the assessments to their respective county boards of equalization, arguing that the valuations established by the county appraisals were too high based on the erroneous inclusion of the present value of the Tax Credits. Both the Wilson and Marshall county boards affirmed the assessments. Taxpayers next appealed to the State Board of Equalization where a contested case hearing was conducted.

At the administrative hearing, Mr. A. Dean Lewis, the State Valuation Coordinator, Division of Property Assessments of the Office of the Comptroller of the Treasury, introduced his appraisals.

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[10]The legislature afforded Taxpayers temporary relief from the increase in their property taxes. Tenn. Code Ann. § 67-4-2009(9) provides:

> There shall be allowed as a credit against the sum total of the taxes imposed by the franchise tax law, compiled in title 67, chapter 4, part 21, and by the excise tax law, compiled in title 67, chapter 4, part 20, certain unbudgeted property taxes associated with LIHTC property. As used herein, "LIHTC property" means property participating, as of June 28, 2000, in the low income housing tax credit program authorized by § 42 of the Internal Revenue Code, and "unbudgeted property taxes" means actual property taxes due on the LIHTC property minus the average property taxes projected for all LIHTC properties in the county in LIHTC program applications filed prior to June 28, 2000 but after 1995 and based on the final applications. With respect to each LIHTC property, the credit exists for five (5) years and shall expire after the fifth year for which it is claimed.

Mr. Lewis gave considerable weight to the income capitalization approach in appraising the properties. This approach determines market value by converting the future benefits of the property into an expression of present worth. In his calculations, Mr. Lewis used both a value-decreasing factor, the lower restricted rents (rather than market rents the properties would command if they were not LIHTC properties), and also a value-enhancing factor, the present worth of the Tax Credits.[11] Mr. Lewis explained:

> The owner contracted with the Tennessee Housing Development Agency to receive tax credits for a ten-year period for the subject propert[ies]. By contract he gave up some of his property rights in order to receive this benefit. These were:
>
> - the right to lease the property to whoever he pleases and for the amount he wishes;
> - the right to sell without restraint;
> - the right to use the property without restraint.
>
> Therefore, in order to properly appraise the subject's fee-simple interest, the full bundle of rights, the present worth of the tax credits must be added to the income value for this is payment for relinquishing the rights listed above. The Administrative Judges in Dickson County and Montgomery County recently rejected the taxpayers agent's argument on the relevance of the tax credits on value. This appraiser has studied cases in three other states as well as a 1994 sample appraisal of a LIHTC project by E. H. Boeckh. Each of these cases state that tax credits definitely affects the value of the real property.

While this case was pending before the Administrative Law Judge ("ALJ"), the parties asked for and the ALJ granted a stay of her ruling pending a decision by the Assessment Appeals Commission in another case that involved both the same issue and the same Taxpayer counsel as the case before us. After the Assessment Appeals Commission rendered its decision in that case, *Appeal of CP Associates, L.P.*, Dickson County, Tax Year 1997 (Assessment Appeals Commission March 25,1999), the ALJ herein entered an initial decision and order affirming the valuations and 1998 assessments for Spring Hill and Greentree, finding that the recently decided *CP Associates* case was controlling. On the same day, the ALJ issued an initial decision and order in Acorn Hills, affirming the valuation and assessment, once again relying on *CP Associates*, which held that the LIHTCs awarded to the owners were a proper value enhancing factor to consider when determining the value of the property. The A.L.J. further found that the Board's reclassification of the Acorn development from residential to commercial property was proper.

[11]Mr. Davis conducted a discounted cash flow analysis to determine the effect of the tax credit on the value of the each property in dispute.

Taxpayers appealed the A.L.J.'s decisions to the Assessment Appeals Commission, which affirmed the valuations underlying the assessments, as well as Acorn's reclassification from residential to commercial. The decisions of the A.L.J. and the Assessment Appeals Commission became final when the State Board of Equalization took no action on the decisions, pursuant to Tenn. Code Ann. § 67-5-1502(k).

Taxpayers then filed petitions for review in the Davidson County Chancery Court pursuant to Tenn Code. Ann. § 67-5-1511.[12] The trial court rejected Taxpayers' arguments and upheld the decision of the Board. The court determined that the LIHTCs were properly included in the valuation of the subject properties for tax assessment purposes and that the Acorn reclassification from residential to commercial was proper. The court concluded:

> The main issue before the Court is whether the federal tax credits enjoyed by the owners of the subject properties affect the value of those properties. Those tax credits made ownership of the properties more desirable to Petitioners. Further, because the tax credits may be transferred to purchasers, they enhance the value of the properties in the marketplace. The Court concludes that the LIHTCs were properly included in the valuation of the subject properties for tax assessment purposes. Accordingly, the decision of the State Board of Equalization is upheld.

Taxpayers filed timely appeals to this court.

II. STANDARD OF REVIEW

Tenn. Code Ann. § 67-5-1511 provides in pertinent part:

> (a) The action of the State Board of Equalization shall be final and conclusive as to all matters passed upon by the board, subject to judicial review, and taxes shall be collected upon the assessment determined and fixed by the board.
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> (b) The judicial review provided in subsection (a) shall consist of a new hearing in the chancery court based upon the administrative record and any additional or supplemental evidence which either party wishes to adduce relevant to any issue. . . . .

Although the possibility of presenting additional evidence in the trial court differentiates this type of case from most reviews of administrative decisions, judicial review of a Board of Equalization decision clearly falls under the Uniform Administrative Procedures Act ("UAPA"). *Willamette*

[12]The trial court entered an agreed order providing that the court would hear the cases together. The court, however, did not consolidate the cases because of the additional issue in Acorn regarding whether it had been improperly re-classified as commercial property.

Industries, Inc. v. Tenn. Assessment Appeals Comm'n, 11 S.W.3d 142, 147 (Tenn. Ct. App. 1999). Accordingly, courts are to apply "the narrow, statutorily defined standard contained in [Tenn. Code Ann.] § 4-5-322(h) rather than the broad standard of review used in other civil appeals." *Wayne County v. Tenn. Solid Waste Disposal Control Bd.*, 756 S.W.2d 274, 279 (Tenn. Ct. App. 1988).

In accordance with Tenn. Code Ann. § 4-5-322(h), a reviewing court may reverse or modify the administrative agency decision if the rights of the petitioner have been prejudiced because the administrative findings, inferences, conclusions or decisions are:

> (1) In violation of constitutional or statutory provisions;
> (2) In excess of the statutory authority of the agency;
> (3) Made upon unlawful procedure;
> (4) Arbitrary or capricious or characterized by abuse of discretion or clearly unwarranted exercise of discretion; or
> (5) Unsupported by evidence which is both substantial and material in light of the entire record.
>
> In determining the substantiality of evidence, the court shall take into account whatever in the record fairly detracts from its weight, but the court shall not substitute its judgment for that of the agency as to the weight of the evidence on questions of fact.

In a review of a decision made by an administrative agency following a contested case proceeding, the standard of review in this court is the same as it is in the chancery court. *Terminix Int'l Co., L.P. v. Tenn. Dept. of Labor*, 77 S.W.3d 185, 191 (Tenn. Ct. App. 2001). Thus, both the trial court and the appellate court should review factual issues upon a standard of substantial and material evidence. *Wayne County*, 756 S.W.2d at 279; *Humana of Tenn. v. Tenn. Health Facilities Comm'n*, 551 S.W.2d 664 (Tenn. 1977). Although not clearly defined, substantial and material evidence "requires something less than a preponderance of the evidence but more than a scintilla or glimmer." *Wayne County*, 756 S.W.2d at 280. This court must carefully review the record, but may not substitute our judgment regarding the weight of the evidence for that of the Board, even where the evidence could support a different result. *Gluck v. Civil Service Comm.*, 15 S.W.3d 486, 490 (Tenn. Ct. App. 1999)*; Willamette,* 11 S.W.3d at 147.

Additionally, courts will generally defer to decisions of administrative agencies on questions involving complex or technical areas within the agency's expertise. *Wayne County*, 756 S.W.2d at 279-80. "[T]he legislature established specific administrative agencies to determine property values which have acquired extensive knowledge and expertise. The process of valuing property is intensely factual, and flexibility is necessary for the expert agencies to value property in wide ranging circumstances." *Willamette*, 11 S.W.3d at 146. Tax assessments are presumed valid, and the taxpayer has the burden of proving they are erroneous. *Edmundson Management Service Inc. v. Woods*, 603 S.W.2d 716, 717 (Tenn. 1980).

An allegation under Tenn. Code Ann. § 4-5-322(h)(l) that an agency decision was made in violation of a constitutional or statutory provision includes an allegation that the agency interpreted or applied a statute incorrectly. Where the resolution of an issue presented in a judicial review of an administrative decision under the UAPA hinges upon the interpretation and application of a statute, courts will review the question de novo. *King v. Pope*, 91 S.W.3d 314, 318 (Tenn. 2002). That is because construction and application of a statute present questions of law, and review of questions of law is de novo, with no presumption afforded to the conclusions of the court below. *Id.*

Further, Tennessee case law is clear that when construing tax statutes the "[w]ords employed by the General Assembly in the enactment of tax statutes are to be taken in their natural and ordinary sense" and "liberally construed in favor of the taxpayer and against the taxing authority." *Covington Pike Toyota, Inc. v. Cardwell*, 829 S.W.2d 132, 135 (Tenn. 1992). Furthermore, "[s]tatutes levying taxes will not be extended by implication beyond the clear import of the language used, nor will their operation be enlarged so as to embrace matters not specifically pointed out, although standing on close analogy." *Id.*; *See Union Carbide Corp. v. Alexander*, 679 S.W.2d 938, 942 (Tenn. 1984). "In interpreting statutes the legislative intent must be determined from the plain language it contains, read in the context of the entire statute, without any forced or subtle construction which would extend or limit its meaning." *National Gas Distributors, Inc. v. Taylor*, 804 S.W.2d 66, 67 (Tenn. 1991).

The taxpayers and the Board differ somewhat on the appropriate standard of review. Taxpayers assert the issue they raise is one of law and, consequently, our review is *de novo* with no presumption of correctness. They define the issue as whether it is lawful under the Tennessee Constitution and relevant statutes to include the LIHTCs in the assessed value of the real property. On the other hand, the Board asserts this case presents a mixed question of law and fact involving the proper appraisal methodology, an area within the expertise of the Board, and that courts should defer to decisions by administrative agencies in their area of specialized knowledge, experience, and expertise.

III. TREATMENT OF THE TAX CREDITS

The essence of the Taxpayers' appeal is that the Tax Credits are intangible personal property that cannot be taxed without legislative authority to do so and no such authority exists. Specifically, Taxpayers argue that the LIHTCs are intangible property as defined in Tenn. Code Ann. § 67-5-501(5) and that although the Tennessee Constitution recognizes intangible personal property as a potentially taxable class of property, the state legislature has not acted to provide statutory procedures for specifically taxing Tax Credits.[13] Because the Tax Credits meet the statutory definition of intangible property, they argue, there is no reasonable construction under the Property Tax Act that would allow inclusion of the value of the Tax Credits in the value of real property for assessment

[13]While it is true that in many states intangible property is exempt from property taxation, *see Salt Lake City Southern R.R. Co. Inc. v. Utah State Tax Comm'n*, 987 P.2d 594, 597 (Utah 1999); James A. Amdur, *Inclusion of Intangible Asset Values in Tangible Property Tax Assessments*, 90 ALR 5TH 547 (2001), Taxpayers correctly recognize that this is not the law in Tennessee.

purposes.

On the other side, the Board asserts that Taxpayers are incorrect in equating the inclusion of the present value of the Tax Credits as a value-enhancing factor in assessing the real property to which they are attached with taxing the credits themselves. The Board argues that under relevant law it is appropriate to include all interests in the real property in assessing its value and to consider value-enhancing as well as value-reducing factors. The Board's position is that, regardless of whether the Tax Credits could be characterized as intangible property, they are indisputably a factor properly included in the assessment.

A. CONSTITUTIONAL AND STATUTORY SYSTEM FOR TAXING PROPERTY

We begin our analysis with the source of all taxing authority in Tennessee, our Constitution. Article II, § 28 of the Tennessee Constitution provides that all property real, personal, or mixed shall be subject to taxation. For purposes of taxation, property is to be classified into one of three distinct classes: (1) real property, (2) tangible personal property, and (3) intangible personal property TENN. CONST. Art. II, § 28; *In the Matter of All Assessments*, 58 S.W.3d 95,98 (Tenn. 2000).

Pursuant to this Constitutional authority, the General Assembly has enacted a system for taxation of property, The Property Tax Act, Tenn. Code Ann. § 67-5-101 *et seq*. Under that system, "All property, real and personal, shall be assessed for taxation for state, county and municipal purposes, except such as is declared exempt in part 2 of this chapter, or unless otherwise provided." Tenn. Code Ann. § 67-5-101. For purposes of taxation, all property must be classified into one of three classes, real property, tangible personal property, and intangible personal property, and the proper ratio of assessment to value must be applied uniformly. Tenn. Code Ann. § 67-5-503.[14]

Article II, § 29 empowers the General Assembly to authorize counties and incorporated towns to impose taxes "in such manner as shall be prescribed by law; and all property shall be taxed according to value, upon the principles established in regard to State taxation." Tennessee Code Annotated § 67-5-102(a)(1) permits counties to levy an *ad valorem* (according to its value) tax on all property subject to property taxation. Such taxes are to be imposed on the value of the property, "as the same is ascertained by the assessment for state taxation." Tenn. Code Ann. § 67-5-102(b).

Thus, before the State or a county can tax any property, that property must be classified so that the appropriate ratio of assessment to value can be established. Definitions of the three property classes are set out in Tenn. Code Ann. § 67-5-501. Taxpayers in the case before us assert that the Tax Credits fall within the statutory definition of intangible personal property and should be classified as

[14]"The ratio of assessment to value of property in each class or subclass shall be equal and uniform throughout the State, the value and definition of property in each class or subclass to be ascertained in such manner as the Legislature shall direct." TENN. CONST. Art. II, § 28.

such.[15] The pertinent statutory provision states:

> 'Intangible personal property' includes personal property, such as money, any evidence of debt owed to a taxpayer, any evidence of ownership in a corporation or other business organization having multiple owners, and all other forms of property, the value of which is expressed in terms of what the property represents rather than its own intrinsic worth. 'Intangible personal property' includes all personal property not defined as 'tangible personal property.'

Tenn. Code Ann. § 67-5-501(5).[16]

The Board does not dispute Taxpayers' contention that no specific statutory authority exists for taxing the credits as intangible property, but argues that the inclusion of the Tax Credits in the assessment of the value of the housing complexes is not a tax on the credits themselves. Further, they assert that the law regarding assessment of real property authorizes consideration of the credits.

The statutory definition of real property "includes lands, tenements, hereditaments, structures, improvements, movable property assessable under § 67-5-802, or machinery and equipment affixed to realty (with exceptions) and all rights thereto and interests therein, equitable as well as legal." Tenn Code Ann. § 67-5-501(9) (emphasis added).

As set out above, Article II, § 29 requires that property be taxed according to value. This court has noted, "The constitution does not give any clue as to how value is to be determined; instead it leaves the method of determining value to the legislature." *Marion County v. State Bd. of Equalization*, 710 S.W.2d at 523. The Constitution grants broad authority to the General Assembly regarding valuation of property. *Assessments*, 58 S.W.3d at 99. The statutes enacted in exercise of the authority to set the method of determining value include Tenn. Code Ann. § 67-5-601(a), which provides in pertinent part, "[t]he value of all property shall be ascertained from the evidence of its sound, intrinsic and immediate value, for purposes of sale between a willing seller and a willing buyer without consideration of speculative values. . . ."

The sound, intrinsic and immediate value of property is to be ascertained in accordance with official assessment manuals issued pursuant to law. Tenn. Code Ann. § 67-5-601(b) and § 67-5-602(b). Further,

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[15]Also under TENN. CONST. Article II, § 28, the legislature has the power to classify Intangible Personal Property into subclassifications, and to establish a ratio of assessment to value in each class or subclass, and to provide fair and equitable methods of apportionment of the its value.

[16]In the absence of a statutory definition of intangible property for sales tax purposes, the Tennessee Supreme Court has stated that intangible property has no intrinsic and marketable value, but is merely the representative or evidence of value or the medium of exchange. *State v. Sanders*, 923 S.W.2d 540, 542-43 (Tenn. 1996).

For determining the value of real property, such manuals shall provide for consideration of the following factors:

(1) location;
(2) current use;
(3) whether income bearing or non-income bearing;
(4) zoning restrictions on use;
(5) **legal restrictions on use**;
(6) availability of water, electricity, gas, sewers, street lighting, and other municipal services;
(7) inundated wetlands;
(8) natural productivity of the soil. . . .;
(9) **All other factors and evidence of value generally recognized by appraisers as bearing on sound, intrinsic and immediate economic value at the time of assessment**.

Tenn. Code Ann. § 67-5-602(b) (emphasis added).

Thus, the statutory system recognizes (1) that all interests in land are included as real property; (2) that the tax is to be based upon the sound, intrinsic and immediate, not speculative, value; (3) that value reflects the price between a willing buyer and a willing seller; and (4) that all factors generally recognized as bearing on the value should be considered.

B. FACTORS BEARING ON VALUE

The potential for generating income is a factor affecting value. Article II, § 28 classifies real property into four categories. Residential real property containing two or more rental units is classified as industrial and commercial property. *Id*.; Tenn. Code Ann. § 67-5-501(4). The classification is based upon the recognition of the use of such rental property as income-producing, thereby justifying a different tax treatment from that afforded owner-occupied residential property. *Castlewood v. Anderson County*, 969 S.W.2d 908, 910 (Tenn. 1998); *Snow v. City of Memphis*, 527 S.W.2d 55, 66 (Tenn. 1975). In the valuation of income-producing real property, it is customary to include that potential or projected income. Taxpayers do not contend otherwise.

Although the appraisals at issue herein discuss three approaches to appraisals of real property, only two are relevant: the cost approach and the income approach.[17] Mr. Lewis calculated the improvement value, adjusted for local market values, to arrive at a value based on the cost approach. Then, applying the income (or income capitalization) approach, which determines market value based upon the properties' ability to generate revenue, the future benefits of the property were converted into present worth. After correlating the values determined by each method, Mr. Lewis recommended a final value for each property. According to the Board's brief, he gave "considerable weight" to the

[17]Except for the land value portion of the appraisals, Mr. Lewis did not consider the comparable sales approach applicable.

income capitalization approach but also gave "heavy weight" to the cost approach.

The law does not require that any particular appraisal methodology be used, and courts will not substitute their judgment for that of the agency regarding which appraisal method is most appropriate. *Willamette*, 11 S.W.3d at 149. Any recognized method whose use is supported by substantial and material evidence and that results in valuation of the property's immediate intrinsic value is sufficient. *Id*.; *Westvaco Corp. v. Tenn. Assessment Appeals Commission*, No. M1999-01206-COA-R3-CV, 1999 WL 1072586 (Tenn. Ct. App. Nov. 30, 1999) (no Tenn. R. App. P 11 application filed). The income capitalization method is commonly used and appropriate to value income-producing real property. *See Seaton v. Tenn. Bd. of Equalization*, No. E1998-00880-COA-R3-CV, 2000 WL 852123 (Tenn. Ct. App. Jun. 28, 2000) (Tenn. R. App. P 11 application denied Feb. 20, 2001). Taxpayers maintain that they are not challenging the appraisal methodology used.

Obviously, many of the statutory factors to be considered in determining value are intangible. The legislature clearly envisioned that intangible aspects of the property would be included in valuation. The potential to produce income in the future is itself an intangible. This court has held that the statutes on valuation of property established as taxing policy the practice of appraisers considering the use of that property and the income produced by it. *Nat'l Life & Accident Insur. Co. v. Keaton*, No. 85-326-II, 1986 WL 4846, at *2 (Tenn. Ct. App. April 23, 1986) (no Tenn. R. App. P. 11 application filed). In that case, the taxpayers argued that a lease for computer equipment and the income from that lease were intangible personal property, similar to the argument herein, and the court found that fact did not prevent considering that lease and income therefrom to enhance the value of the property. *Id*. at *3. The court concluded that "[a]n assured substantial income from property is a major element of its value." *Id*., at *5.[18] The court quoted with approval cases from other states to the effect that present and reasonably anticipated income are relevant to the price a willing buyer would pay for income-producing property. *Id*., at *3-4.

The valuation herein took into account the value-decreasing effect on the property of various intangibles, specifically the restrictions on its use imposed as part of the LITHC program. A restriction on the use of land is properly considered in determination of value. Tenn. Code Ann. § 67-5-602(b); *Marion County*, 710 S.W.2d at 523. Where a property owner voluntarily restricts the use of his or her property, "that restriction affects the property's value." *Id*. Because the subject of the tax is the real property, not a particular owner or possessor's interest in the property, restrictions affecting valuation for tax purposes are those that run with the land rather than those that are personal to the parties in possession. *Hoover v. State Bd. of Equalization*, 579 S.W.2d 192, 195-96 (Tenn. Ct. App. 1978).

The Board contends that intangible factors that enhance the value of the properties at issue should be considered along with those that decrease the value. Or, as the appraiser stated, the "full

[18]Additionally, to taxpayers' argument that the legislature had not seen fit to tax leases, the court responded that the obvious reason was that a lease is an interest in the property and "the profitable or unprofitable incidents of the lease attach to and affect the value of the property." *Id*., at *5.

bundle of rights," both value-enhancing and value-decreasing, must be factored into the valuation. The Board has historically maintained that an assessment of income-producing real property should include intangibles that are directly related to the use of the real property. This position is also supported by courts in numerous jurisdictions. *See, e.g., Merle Hay Mall v. City of Des Moines Bd. of Rev.*, 564 N.W.2d 419 (Iowa 1997) (holding intangible "business enterprise value" may be considered by assessor); *E. Liverpool Landfill Inc. v. Columbiana Cty. Bd. Of Revision*, 690 N.E.2d 1371 (7th Dist. Columbiana County OH 1997) (holding business value as a landfill was inseparable from the real estate and should be used in determining real property taxable value); *Humble Oil & Refining Co. v. Borough of Englewood Cliffs*, 342 A.2d 560 (N.J. App. Div. 1975) (holding valid nonconforming use that allowed the real property to be operated as a gasoline service station was properly considered in the assessment property); *Waste Management of Wisconsin, Inc. v. Kenosha County Bd. Of Review*, 516 N.W.2d 695 (WI. 1994) (holding "transferable income-producing capacity" of real estate properly considered by assessor); *State ex rel. N/S Associates by JMB Group Trust IV v. Board of Review of Village of Greendale*, 164 Wis. 2d 31, 473 N.W.2d 554 (Ct. App. 1991) (finding assessor properly included the value of shopping mall's transferable income-producing capacity, "inextricably intertwined" with real estate);*see generally* James A. Amdur, *Inclusion of Intangible Asset Values in Tangible Property Tax Assessments*, 90 ALR 5TH 547 (2001).[19]

This view, expressed in the Board's administrative decision in *Appeal of Troy Place Apartments*, Obion County, 1992 Tax Year (Assessment Appeals Commission), has formed the Board's longstanding policy of including the value of government incentives that make projects economically feasible, such as rent subsidies, mortgage interest subsidies, and government insured low-interest mortgages, as a factor in determining fair market value of real property.[20] Indeed, the

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[19]Although some intangibles have been determined to be excludable, they generally fall into the category of rights personal to the owner, not running with the land. *See, e.g., County of Orange v. Orange County Assessment Appeals Bd.*, 16 Cal. Rptr.2d 695 (4th Dist. 1993) (holding improper to consider value of cable television company's franchises and licenses); *Hecht v. Dade County*, 234 So. 2d 709 (Fla. Dist. Ct. App. 3d Dist. 1970) (holding improper to consider value of dog racing track's wagering license); *Metropolitan Dade County v. Tropical Park, Inc.*, 231 So. 2d 243 (Fla. Dist. Ct. App. 3d Dist.1970) (holding improper to consider value of horse racing track's wagering license).

[20]The Board's interpretation is consistent with the treatment by other courts of other federal subsidy programs which treat the subsidies as having a significant impact on the value of the properties and therefore included when determining the fair market value for property tax purposes. *See Maples v. Kern County Assessment Appeals Bd.*, 117 Cal. Rptr. 2d 663 (Cal. App. 5th Dist. 2002) (holding assessor entitled to consider the effective interest rate of 1% paid by taxpayer to develop low-income apartment complex in its valuation of property tax); *Kankakee County Bd. of Review v. Property Tax Appeal Bd.*, 544 N.E.2d 762 (Ill. 1989) (holding assessor properly considered both the positive effect of a government rent subsidy on the value of a subsidized apartment for elderly residents and also the negative effects of the restrictions placed on the owner); *Pedcor Investments v. State Bd.Tax* Comm., 715 N.E.2d 432 (Ind. Tax 1999); (concluding that tax incentives from federal subsidy offset deed restrictions that may create economic obsolescence); *In re: Ottawa Housing, L.P.*, 10 P.3d 777 (Kan. Ct. App. 2000) (holding taxing authority should consider the effects of the low-income housing contract when valuing property for *ad valorem* taxes); *New Walnut Square; Ltd. Partnership v. Louisiana Tax Com'n*, 626 So. 2d 430 (La. Ct. App. 4th Cir. 1993) (holding appropriate to consider as "income" the subsidized low-interest mortgage used to finance complex for property tax purposes); *Glenridge Development Co. v. City of Augusta*, 662 A.2d 928 (Me. 1995)(holding assessor properly considered both the interest subsidy payments made by federal government, as well as the rent ceiling in his income approach valuation); *Dowagiac Ltd. Dividend Housing Ass'n v. City of Dowagiac*, 420 N.W. 2d 114 (Mich. App. 1987) (holding assessor properly considered low-income

decision in *Troy Place* served as the precedent for the Board's decision in *CP Associates*, *infra*, and the appeals now before this court.

In *Troy Place*, the taxpayer received a federal subsidy in the form of a low-interest loan to develop property that, in exchange for the federal subsidy, was subject to restricted rents. In determining the value of the property, the Board approved the assessor's inclusion of the debt subsidy in the determination of market value. The reason underlying the decision to use the debt subsidy in *Troy Place* is exactly the reasoning underlying the assessor's decision to factor in the Tax Credits here, *i.e.*,the real economic benefit caused by these federal subsidies has a significant impact on the value of the property and must, therefore, be analyzed when determining the fair value of the property. The Commission stated in *Troy Place*, "any prospective purchaser would look at the rent and the interest subsidy together in estimating income."

As discussed earlier, the appraisal in *CP Associates* involved the same LIHTC credits at issue in the case before us, the ALJ stayed her ruling on the appraisals herein pending the Assessment Appeals Commission ("AAC") decision in *CP Associates*, and the decision herein was based upon the *CP Associates* ruling. The taxpayer in *CP Associates* did not argue that the underlying reasoning of *Troy Place* was incorrect, but instead argued that syndication of the Tax Credits was sufficient to distinguish the cases. The AAC was not persuaded that a true distinction existed and found that although the owner of the property had, by the limited partnerships, internally allocated the right to receive the Tax Credits to limited partners in exchange for a discounted lump sum payment by investors, the assignment of this right is the equivalent of any number of other financing tools available. The AAC found that if the Tax Credits were excluded from the appraisal, one of the most valuable benefits of ownership of the property would result in a gross understatement of actual value:

> We have generally considered actual rental income for an apartment property a reasonable starting point for projecting future benefits, except in the case of properties which legally restrict rent in return for other benefits to the owners. Thus in valuing apartments financed under a federal program obligating the owner to rent

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project's reduced interest as factor in valuation where trial court rejected taxpayers argument that assessor was improperly taxing the intangible "business value"); *Meadowlanes Ltd. Dividend Housing Ass'n v. City of Holland*, 473 N.W.2d 636 (1991), *reh'g denied*, (Sept. 17, 1991) and on remand to, 1993 WL 302444 (Mich. Tax Trib. 1993) (subsidy makes the property economically feasible and therefore had to be considered in the valuation process); *Supervisor of Assessments of Baltimore City v. Har Sinai West Corp*, 622 A.2d 786 (1993) (Me. App. 1993) (holding inclusion of HUD rent subsidy appropriate in valuation for property tax purposes); *Rebelwood, Ltd. v. Hinds County*, 544 So. 2d 1356, 1364 (Miss. 1989)(holding that because the benefits of participating in a federal low-income housing program affect the value of the property in the open market, they must sensibly be considered in assessing value); *In re Johnson Associates*, 431 A.2d 932 (Md. App. 1981) (holding assessor must consider both the positive and negative effects of the subsidized property); *Alta Pacific v. Utah State Tax Com'n*, 931 P. 2d 103, 115-16 (Utah 1997) (holding effects of low-income housing contract should have been considered in assessment); *but see Piedmont Plaza Investors v. Dept. of Revenue*, 331 Or. 585, 18 P.3d 1092 (2001)(assessment best calculated without making adjustment for the federal interest subsidy); *Alliance Towers, Ltd. v. Stark County Bd. Of Revision*, 523 N.E.2d 826 (Ohio 1988), *appeal after remand*, 552 N.E. 2d 632 (1990)(artificial effects of the federal housing assistance program not indicative of the value of the real estate).

at below market rates to low-income persons, we declined to limit value to a capitalization of actual rents where the owner also received an interest -subsidized loan to over the cost of construction (Appeal of Troy Place Apartments, an Assessment Appeals Commission decision from Obion County for tax year 1992). The difference in the parties' estimates of value in this case owes to the assessor's attempt to account for anticipated benefits of ownership that go beyond the restricted rents. Here the assessor performed a variation of income capitalization method, discounted cash flow analysis (DCF), that utilized actual property rents but included an increment of value attributable to the LIHTC Program tax credits. The resulting contention of value ($6,5000,000) significantly exceeds the assessor's original appraisal of the property.

Taxpayer's agent argues this case should be distinguished from *Troy Place* because the tax credits in this case will not transfer with the property on sale the way the interest subsidy in *Troy Place* would, because the owner in this case has already sold the credits. The LIHTC Program allows the original developer to retain the credits for gradual use over time or the developer may sell the credits at present value (to others for gradual use over time) and use the proceeds to help finance construction. In this case the developer and present owner of Trails of Dickson sold the credits ($5,376.106 to be taken over ten years) for a lump sum of $3,010.600. This advance use of one of the attributes of the property does not diminish the value of the property, however, any more than if, as Judge Loesch [the ALJ] suggested, the owner/seller had previously assigned to a third party the right to receive a portion of the rents (citation omitted) or if the owner/seller had received prepayments of rent to be adjusted out of the selling price.

The actual benefits and burdens associated with ownership of the real property, the burden of below-market contract rents or the benefit of interest avoided or tax credits received, reveal how transactions involving the property relate to market realities. The tax credits here illustrate why the below market rents are not the complete picture vis-a-vis the real property, why net operating income or an income approach limited to these rents alone is not reflective of the real property value.[21]

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[21]The AAC explained the last statement in a footnote which stated:

Considering the original loan amount ($3,825,400) for this property and the proceeds of the sale of tax credits ($3,010,600), the owners funded the total cost of this property ($7,050,159) with an equity investment of only $214,159. When annual debt service on the original loan ($333,639) is deducted from annual net operating income ($422,500), the property produces annual cash flow of $88,861, a return on the original equity of over 40%. If the owners applied the program developer's profit ($737,000) to the required equity, they incur no initial investment requirement at all and instead clear $523,000 at the outset. These factors may illustrate why, as one witness testified, there are three applications submitted for every one applicant chosen to participate in the program.

C. ANALYSIS

Although this is a question of first impression in Tennessee, a number of other states have examined the LIHTC Program. While some have found that the Tax Credits should not constitute a factor in assessing the value of real property,[22] the majority take the position that, absent legislation to the contrary, the Tax Credits should be used as a factor in determining the fair market value of the real property upon which they were awarded. We find these cases the more persuasive because of the similarity between the tax statutes and valuation standards involved therein and those applicable in Tennessee.

Under state law making the purpose of a valuation the determination of fair cash value, based upon the willing buyer-willing seller concept, and income-producing capacity the most significant element in arriving at fair cash value, an Illinois appellate court held that LIHTC credits are to be included in the valuation. The court held that both the positive and negative impacts on value of the arrangement must be considered in order to accurately reflect the value. Because the restricted rents were also considered, "[i]gnoring the effect of the tax credits would distort the earning capacity, and thus the fair cash value, of the property as low-income housing." *Rainbow Apartments v. Illinois Property Tax Appeal Bd.*, 762 N.E.2d 534, 536 (Ill. App. 2001). The court specifically held that a willing buyer would most certainly consider the availability of the credits when determining the fair cash value of the property. *Id.* at 537.

Similarly, the Court of Appeals of Georgia considered inclusion of LIHTC credits in valuation under state law requiring that property be taxed at its fair market value, defined again as the amount a knowledgeable buyer would pay and a willing seller would accept for the property. *Pine Pointe Housing, L.P. v. Lowndes County Bd. of Tax Assessors*, 561 S.E.2d 860, 863 (Ga. App. 2002). State law required consideration of a number of factors in determining fair market value, including zoning, use restrictions, and "any other factors deemed pertinent." *Id.* The court determined that the LIHTC credits were pertinent because:

> the credits have value to a taxpayer with federal income tax liability and can be 'passed through' a partnership structure to those taxpayers. Because Section 42 tax credits are generated by a designated property, a third party would pay for the value as part of that property's sale price in a bona fide, arm's length transaction. Furthermore, the tax credits go hand in hand with the restrictive covenants that require the property to charge below market rent.

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[22] *See Cottonwood Affordable Housing v. Yavapai Co.*, 72 P.3d 357 (Ariz. 2003)(finding Tax Credits intangibles and therefore unlawful to tax); *Maryville Properties , L.P. v. Nelson*, 83 S.W.3d 608 (Mo. Ct. App. 2002) (finding Tax Credits intangibles, and Missouri state law prohibits property taxation of intangibles); *Bayridge Assoc. Ltd. v. Dept. of Revenue*, 892 P.2d 1002 (Or. 1995) (finding Tax Credits governmental restrictions, as defined by statute and under Oregon law not permitted to be considered in determining market value); *Cascade Court Ltd v. Noble*, 20 P.3d 997(Wash. Ct. App. 2001) (finding Tax Credits intangibles, and Washington state law prohibits taxation of intangibles).

Id. at 863. The court found that state law required consideration of the restricted rents, and, consequently, "if viewed in isolation, the rental restrictions would artificially depress the value of the property for tax valuation purposes." *Id*.

Relying on an earlier holding that rent restrictions as well as tax shelter benefits inherent in another federally subsidized housing arrangement must be considered in valuation, the court in *Parkside Townhomes Associates v. Bd. of Assessment Appeals of York County*, 711 A.2d 607 (Cmnwlth Ct. Penn. 1998), held that § 42 LIHTC credits were properly included in valuation because the effect of the tax credits was "part of the economic reality." *Id*. at 611. "Tax related benefits associated with investment property ownership inherently affect value and the court is not constrained to determine FMV [fair market value] as though the property lacked tax shelter features." *Id*., citing *In re Johnstown Associates*, 431 A.2d 932, 935 (Pa. 1981).

In these cases, the courts determined that only consideration of both the value-decreasing factor of restricted rents along with the value-increasing factor of the Tax Credits provides a full and accurate picture of the property's worth. *See also Greenfield Village Apts. v. Ada County*, 938 P.2d 1245 (Idaho 1997) (McDevitt, J., concurring) (noting that Tax Credits must be considered if rent-restriction considered.) We agree. Whether the issue is consideration of the propriety of reducing valuation due to restricted rents or of including investment or tax benefits, the better and more widely accepted approach is that both or all aspects of the arrangement should be considered. *See In re Ottawa Housing Assoc., L.P.*, 10 P.3d 777 (Kan. Ct. App. 2000) (considering rent restrictions in LIHTC properties and discussing various cases on low-income housing subsidy arrangements). In that case, the court concluded:

> These cases apply the general theory that a low income housing contract is an investment tool for maximizing an investment in real estate. Buyers and sellers of real estate consider these tools in determining the market value of real estate.

Id. at 780. Because Kansas defined fair market value in terms of the willing buyer - willing seller concept, the court concluded the stated investment principles were consistent with that definition. Therefore, both benefits and burdens of the § 42 housing arrangement should be considered.

In *Deerfield 95 Investor Associates, L.L.C. v. Town of East Lyme*, 25 Comm. L. Rptr. 51, 1999 WL 391099 (Conn. Super. 1999), the court found that the "four principal component benefits of an LIHTC project are (1) low-income housing tax credits; (2) cash flow; (3) depreciation losses, . . . and (4) residual value," citing R. Polton, *Valuing Property Developed with Low-Income Housing Tax Credits*, THE APPRAISAL JOURNAL, July 1994, p. 450. The court found that just like other intangibles such as zoning and location, subsidized financing and subsidized rent affect the value of the property and, consequently,

> . . . LIHTCs, although intangibles, do have an effect on the valuation of real estate for assessment purposes and should be a factor in determining the fair market value . . .

Id., at *6.

We conclude that the approach used by the appraiser herein is consistent with the statutes on valuation of property for property tax purposes. As the trial court herein correctly recognized, the issue is "whether the price that a willing buyer and seller would agree upon would take into account the tax credits." Stated another way, do the Tax Credits bear on the intrinsic value of the property to which they relate? Intangible factors should be considered when they affect the value, either upward or downward. We find nothing inconsistent with the relevant statutes or Constitutional provisions in considering these factors. The valuation herein considered both the restricted rents and the Tax Credits.

D. TAXPAYERS' ARGUMENTS

Taxpayers have the burden to show that the valuation does not conform to legal requirements. As stated above, Taxpayers argue that the credits are intangible property and their inclusion in valuation of the real property is an unauthorized tax on that intangible property. Taxpayers also argue, however, that inclusion of the Tax Credits in this case is improper because those credits have been sold. Thus, they assert, a willing buyer would not include the credits in his or her purchase price because he or she would not receive any remaining credits as part of the purchase of the real property. Taxpayers also assert that LIHTC credits are fundamentally different from other government subsidies and that cases and principles relating to those subsidies should not be applied to the LIHTC program benefits. In particular, Taxpayers assert, with government programs that subsidize the operating costs of restricted-rent housing (through decreased interest or subsidized rents) the subsidy directly affects the projected income stream. The Tax Credits involved herein, they argue, are essentially reimbursements of construction costs and are not used to decrease future operating costs and increase future profits.

We have fully considered these arguments. So have other courts, as discussed herein. For the reasons set out earlier, we have concluded that the inclusion of the Tax Credits is consistent with Tennessee law on real property valuation. Consequently, the Tax Credits are not being taxed as intangible property. While the credits may be characterized as intangibles that affect the value of the property, they are not severable from it. Ownership of the property and agreement to restrict its use are the criteria for award of the credits. Tennessee law allows and has long allowed inclusion of value-affecting intangible factors in the valuation of property. Such inclusion does not constitute a tax on those intangibles.

Taxpayers' arguments that the Tax Credits represent an intangible property right that does not attach to the property, and that the credits in the case before us should not be considered because the right to future credits has been syndicated to the limited partners overlook the fundamental structure and intent of the LIHTC Program as well as the practicalities of the arrangement.

The Tax Credits are irrevocably attached to the real property. An owner who receives Tax Credits must agree to maintain the project's low-income status for at least fifteen years. I.R.C. §

42(h)(6). Here, Taxpayers entered into a thirty year agreement. Taxpayers and THDA entered into a Declaration of Land Use Restrictive Covenants for the LIHTCs. The agreements containing the restrictive covenants are recorded with the Register of Deeds. Taxpayers agreed that all provisions of the LIHTC contract are covenants running with the land.[23] The Tax Credits will be reduced or revoked, and Tax Credits awarded for previous years are subject to recapture by the federal government, if the owner of the property defaults under the restrictive covenants relating to the property. I.R.C. § 42(j).

The Tax Credits are paid to the registered owner of the property on an annual basis for so long as the owner has not breached the restrictive covenants. The owners of the developments herein are the limited partnerships. The Tax Credits were allocated to the limited partnerships as the owners. The limited partnerships are the Taxpayers.

The federal government and THDA are indifferent as to whether or not the owner of the property syndicates the right to use the Tax Credits to limited partners in the limited partnership so long as the owner does not default in the obligation to perform under the restrictive covenants. Likewise, the federal government and the THDA are indifferent as to whether or not the building is sold to a third party so long as the third party "steps in the shoes" of the seller and performs under the restrictive covenants.[24]

The court in *Rainbow Apartments*, 762 N.E.2d at 534, considered the same argument as that made herein: that the LIHTC credits are not part of the real property because they are unrelated intangible assets and are sold prior to the property's development. The court held:

> We disagree with the characterization of the tax credits as intangible property sold and existing apart from the real estate. Section 42 tax credits are not intangible property because they do not constitute a right to a payment of money, have no independent value, and are not freely transferable upon receipt. A limited partnership does not "sell" the tax credits to investors; they remain in the limited partnership. The benefit of a tax credit to a limited partner is entirely incidental to that investment.

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[23]The Declaration of Land Use Restrictive Covenants provided in part:

> Owner intends, declares and covenants on behalf of itself, its successors and assigns and all future owners and operators of the project that, during the Term of this Agreement, all provisions of this Agreement; (I) shall be and are **covenants running with the land**, encumbering the Project; (ii) are **not merely personal covenants of the Owner**. (Emphasis added).

[24]To induce THDA to allocate Tax Credits to them, each Taxpayer agreed that:

> Subject to the requirements of Section 42, the Application [for reservation or allocation of Tax Credits], and this Agreement, Owner may sell, transfer, exchange or refinance not less than the entire Project at any time; provided, however, . . . Owner shall obtain and deliver to THDA the written agreement of any buyer, . . . that such sale. . . . is subject to this Agreement, Section 42 and the Application. . .

Id. at 537 (citation omitted).

The North Carolina Supreme Court recently considered whether the lower rents mandated by a § 42 arrangement must be used in valuation, in the context of determining whether the assessing authority used a legal methodology. *In re Greens of Pine Glen Ltd.*, 576 S.E.2d 316 (N.C. 1997). The court determined the restricted rents need not be considered, but in so doing discussed the nature of the LIHTC arrangement, noting that the taxpayer's contractual agreement under § 42 resulted in rents below market. However, the court found that the taxpayer decided to participate in the LIHTC program as opposed to building and renting apartments on the open market, in order to take advantage of the incentives. "Its participation in the section 42 program created another way to finance taxpayer's building project because the sale of the tax credits generated funds that taxpayers used to construct [the project.] Therefore, the taxpayer's participation in section 42 housing represented a business and economic decision. . . ." *Id*. at 321. Section 42 restrictions balance tax credits allowed to the developer against rent restrictions imposed on the developer. *Id*. at 322.

In the context of the treatment of § 42 Tax Credits under Article 9 of the Uniform Commercial Code the court in *City of Chicago v. Michigan Beach Housing Coop*., 609 N.E.2d 877 (App. Ct. Ill. 1993), found "tax credits cannot be intangible personal property subject to a security interest under Article 9." *Id.* at 885. The court quoted the United States Supreme Court decision in *Randall v. Loftsgarden*, 478 U.S. 647, 106 S. Ct. 3143, 92 L.Ed2d 525 (1986) which addressed the nature of the tax credits in the context of whether they were income for purposes of § 12(2) of the Securities Act of 1933:

> Unlike payments in cash or property received by virtue of ownership of a security–such as distributions or dividends in stock, interest on bonds, or a limited partner's distributed share of the partnership's capital gains or profits– the 'receipt' of tax deductions or credits is not itself a taxable event, for the investor has received no money or other 'income' within the meaning of the Internal Revenue Code.
>
> The *Michigan Beach* court further observed that:
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> Respondents essentially ask us to treat tax benefits as a separate asset that is acquired when a limited partner purchases a share in tax shelter partnership. But the legal form of the transaction does not reflect this treatment. . . .For obvious reasons, tax deductions and tax credits are not, in the absence of a statutory provision to the contrary, freely transferable from one person to another if wholly separated from the property to which they relate. . . . Tax credits, as *Randall* instructs us, have no independent value in and of themselves; . . . . ..Tax credits do not constitute a right to payment of money, have no independent value, and are not freely transferable upon receipt.

Id.

The trial court herein found:

> [Taxpayers' argument] turn[s] on the severability of the tax credits from the subject property. . . .[and] under Internal Revenue Code regulations, tax credits inure to the benefit of a property's owner. . . . a purchaser 'steps into the shoes' of a former owner for purposes of the credits. Internal Revenue Code § 42(d)(7). Therefore, logic dictates that they should be treated as income affecting the property's value.

We conclude that the trial court correctly found the Tax Credits relate directly to the real property and are not an intangible benefit severable and sold to third parties and that they were properly included in the valuation. The Board has properly balanced both the value enhancing factor of the Tax Credits and the value reducing effect of the restricted rents with respect to the properties in dispute and has arrived at a value that reflects the property's sound, intrinsic, and immediate value. Accordingly, we affirm the decision of the trial court with respect to the Board's consideration of the Tax Credits in the 1998 assessments of Spring Hill, Greentree, and Acorn.[25]

IV. RECLASSIFICATION OF ACORN HILLS

Taxpayer Acorn complains that the trial court erroneously affirmed the Board's reclassification of its development from residential to commercial property for tax assessment purposes.[26] Taxpayer argues that the trial court relied too heavily on the fact that the units were income producing and failed to distinguish between multi-unit buildings and single family homes. Taxpayer maintains that the trial court should have sub-classified the 44 single family homes on separately parceled lots as residential property.

Article II, § 28 of the Tennessee Constitution classifies real property into four categories: public utility, industrial and commercial, residential, and farm:

> (a) Public Utility Property, to be assessed at fifty-five (55%) percent of its value;
> (b) Industrial and Commercial Property, to be assessed at forty (40%) percent of its value;

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[25]Taxpayers and *amici* have urged us to consider the policy implications of the inclusion of the Tax Credits in valuation. We note that a number of states have addressed this issue by legislation specifically excluding LIHTC credits from being included in the valuation. The Georgia legislature enacted legislation prohibiting the consideration of tax credits, effective July 1, 2001. OCGA § 48-5-2(3)(B.1). *Pine Point Housing, L.P.*,561 S.E.2d at 202. The Illinois legislature amended the definition of property to exclude § 42 low-income housing tax credits from the definition of property. 35 ILCS 200/1-130. *Rainbow Apartments*, 762 N.E.2d at 537. *See also* Wis. Stat. § 70.32(1g) (effective July 1, 2000, assessor may not consider § 42 Tax Credits effect on value of property). The legislature is the appropriate body to determine public policy on this issue.

[26]Single-family residences and duplexes occupied one-half by the owner enjoy a 25% assessment ratio, while multi-unit apartments and duplexes with both sides rented are assessed at a 40% ratio.

(c) Residential Property, to be assessed at twenty-five (25%) percent of its value, provided that residential property containing two (2) or more rental units is hereby defined as industrial and commercial property; and
(d) Farm Property, to be assessed at twenty-five (25%) percent of its value.

Tenn. Code Ann. § 67-5-501 provides:

> (4). . . .All real property which is used, or held for use, for dwelling purposes which contains two (2) or more rental units is hereby defined and shall be classified as 'industrial and commercial property;'
>
> *****
>
> (10)'Residential property' includes all real property which is used, or held for use, for dwelling purposes and which contains not more than one (1) rental unit. All real property which is used, or held for use, for dwelling purposes but which contains two (2) or more rental units is hereby defined and shall be classified as 'industrial and commercial property.'

The Tennessee Supreme Court addressed a very similar situation in *Castlewood, Inc. v. Anderson County*, 969 S.W.2d 908 (Tenn. 1998), *cert. denied*, 525 U.S. 949, 119 S. Ct. 375 (1998). In *Castlewood*, the Board ruled that rented condominiums, in the same building and under common ownership, should be sub-classified commercial under the Tennessee Constitution and statutes as interpreted in *Snow v. City of Memphis*, 527 S.W.2d 55 (Tenn. 1975).[27] The *Castlewood* Court noted that "the purpose and objective of the [amendment to Art. II, § 28] is to tax income-producing property at a higher rate than owner-occupied residences and farms." *Castlewood*, 969 S.W.2d at 910 (quoting *Snow*, 527 S.W. 2d at 66).

Here, the evidence adduced at the administrative hearing revealed that the owner submitted one application to THDA for low-income housing Tax Credits to construct the 44-unit Acorn Hills project. The property was covered by one warranty deed and one deed of trust and was managed as one property. In addition, there was a restrictive covenant on the land prohibiting the sale of any single unit. The A.L.J. found these facts supported the assessor's position that the units were not separate residential properties, but instead commercial rental units.

The trial court agreed, finding:

> In the present case, the owner of Acorn Hills treats the 44 single-family residences as one multi-unit subdivision. The development was created for commercial purposes, that is, to generate rental income, garner tax credits and thus

[27]The *Snow* decision upheld a constitutional provision requiring that residential properties containing two or more rental units be sub-classified commercial rather than residential. The case involved rental duplexes.

> produce a profit. Petitioners elevate form over substance in arguing that the determinative factor is whether the residences are physically conjoined. The Constitution and the statutes classify property based on its use and purpose. The tax assessor properly determined that the use and purpose of the development was income producing, commercial property and should be taxed at a higher rate than owner occupied residences and farms. In keeping with the rationale underlying the *Castlewood* decision, this court holds that a favored tax classification does not extend to the owner of 44 single family rental units which are, to the owner-taxpayer, income producing property. The Board's decision as to the classification of the Acorn Hills property is upheld.

We agree with the trial court's rationale and affirm its upholding the Board's sub-classification of Acorn as commercial property.

V. EVIDENTIARY ISSUES

A. EXCLUSION OF COMPARISON OF PROPERTY TAXES PAID

Taxpayers argue that the trial court erred in excluding testimony comparing the property taxes paid by LIHTC properties and the property taxes paid by similar, non-LIHTC rental properties. The purpose of the comparison was to demonstrate a large disparity between the percentage of gross revenue the LIHTC properties were paying in property taxes, as opposed to non-LIHTC properties. The trial court sustained the Board's objection on relevancy grounds, finding that LIHTC and non LIHTC rental properties are not the same: . . . ."I can't compare apples to oranges. I have to have the same factual situation."

Generally, a trial court's ruling on the admissibility of evidence is within the sound discretion of the trial judge. Trial courts are accorded a wide degree of latitude in their determination of whether to admit or exclude evidence, and will be overturned on appeal only upon a showing of abuse of discretion. *Rothstein v. Orange Grove Center, Inc.*, 60 S.W.3d 807, 811 (Tenn. 2001); *Otis v. Cambridge Mut. Fire Ins. Co.*, 850 S.W.2d 439, 442 (Tenn. 1992). Upon review of the record in this case, we cannot say that the tax comparison was improperly excluded from evidence by the trial court.

B. EXCLUSION OF STATE SENATOR'S TESTIMONY & LEGISLATIVE HISTORY

Taxpayers argue that the trial court erred in excluding its proffered testimony of Senator Joe Haynes and transcripts and audio tapes of legislative history surrounding proposed legislation SB 2491/HB2584. Taxpayers were attempting to rebut the Board's argument as why the proposed legislation, which would have prohibited tax assessors from considering the value of LIHTC's when

valuing real property, failed.[28]

The trial court declined to admit the evidence but did permit Taxpayers the opportunity to proffer their proof. She explained her ruling as follows:

> I find that the reason why the legislature didn't pass the act in its original form as appears on these tapes is not relevant to the issue of what actually passed. Because argument in counsel's [Board's] brief is only whatever persuasive import I give it. And I may give it none or I may be so persuaded that I just decide that's the whole ball game. But I don't consider the briefs to be substantive evidence. . . .And if I feel even slightly persuaded by what's in the State's brief, I might read the transcript . But my initial approach to this is that I'm dealing with a piece of legislation that has been passed. I don't believe that I get into looking about why they didn't pass some other piece of legislation.

Ultimately, the trial court did not rely upon the Board's argument in its brief about the non passage of the proposed legislation to which Taxpayer objected. Consequently, Taxpayers were not harmed by the court's decision not to consider Taxpayers' evidence regarding the reason for the nonpassage of the bill.

Further, we find that Taxpayers failed to demonstrate the trial court abused its discretion. Indeed, to the contrary, the trial court's ruling was correct.

Legislative inaction, or failure to amend, is generally considered irrelevant to the interpretation of existing statutes. *See Forman v. Nat. Council on Comp. Ins.*, 13 S.W.3d 365, 373 (Tenn. Ct. App. 1999) (discussing the majority view of the effect of legislative inaction); *Blake v. Abbott Labs., Inc.*, No. 03A01-9509-CV-00307, 1996 WL 134947, at *3 (Tenn. Ct. App. Mar. 27, 1996) (no Tenn. R. App. P. 11 application filed) ("proposed legislation, not enacted, has no consequence whatever upon the interpretation of an existing statute"). While in Tennessee failure of the legislature to express disapproval of a judicial construction of a statute is persuasive evidence of legislative adoption of the judicial construction, *Storey v. Nichols*, 27 S.W.3d 886 (Tenn. 2000); *Hamby v. McDaniel*, 559 S.W.2d 774, 776 (Tenn. 1977), that is not the situation in the case before us. With respect to the legal effect of legislative inaction, Judge Koch cautioned in his concurrence in *Sherwood v. Microsoft Corp.*, No. M2002-01850-COA-R9-CV, 2003 WL 21780975, at *35 (Tenn. Ct. App. July 31, 2003)(Tenn. R. App. P. 11 permit filed), to attach little significance, in part because of the inability to identify which of several possible reasons motivated the body as a whole.

We affirm the trial court's evidentiary rulings and also find that Taxpayers failed to show how

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[28]As explained *infra*, 5 n.10, the legislature provided Taxpayers temporary relief from their "underbudgeted" property taxes pursuant to Tenn. Code Ann. § 67-4-2009(9). *See also* Tenn. Op. Atty. Gen. No. 00-66 (opining that bill would be proper exercise of legislature's authority under TENN.CONST. Art. II, § 28 & 29 to exclude Tax Credits from consideration in appraisals).

they were harmed by the trial court's decision not to consider arguments or testimony regarding the import of the legislature's failure to enact a particular piece of proposed legislation.

CONCLUSION

We affirm the trial court's judgment and remand the case to the trial court for whatever further proceedings may be required. Costs of the appeal are taxed to the appellants.

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PATRICIA J. COTTRELL